

# Competition

## and Development

### THE POWER OF COMPETITIVE MARKETS

## 2

## Privatization Alone Is Not Enough

The sale of Egyptian state interests in cement was only the beginning in a long process to establish an efficient and competitive industry.

*The privatization of state-owned companies attracted new players to Egypt's cement industry and generated export growth. But at the time, the market wasn't regulated to ensure fair play among businesses. New legislation is now helping to rid it of anticompetitive behaviour.*

In just over 10 years Egypt stopped having to import cement and became a major cement exporter. Privatization played a leading role in this transformation.

In common with many developing countries in the late 20th century, the Egyptian state had, until recently, majority stakes in most major industrial companies. That situation is changing as the government attempts to modernize the economy through a range of measures that include

privatizing state-owned companies. The goal of privatization is to increase economic growth, but the transition from a state-run to a free-market economy has not been without its problems. The recent history of Egypt's cement industry is a case in point.

The industry got its start 80 years ago with the creation of Torah Cement, a joint venture between Swiss and Egyptian capital, explains Ahmed Farouk Ghoneim, associate profes-

sor of economics at Cairo University. Over the next several decades many more cement factories opened. The government established the "Office of Selling Egyptian Cement" with cement manufacturing representatives to coordinate national cement production and marketing in local and foreign markets.



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In the 1960s, the Government of Egypt began nationalizing the industry. By the early 1990s, the entire sector comprising more than a dozen companies was state owned. And by 1993 Egypt was the second largest *importer* of cement in the world, Ghoneim states in an IDRC-funded study on Egyptian cement, part of a seven-country research project to identify policy interventions that can foster competitive markets in developing countries.

## Privatization sparks growth

Clearly, something had to be done. In the late 1990s, the private sector entered the market with new plants. In a period of 30 months, starting in 1999, the government privatized seven of the largest firms, representing more than two-thirds of total production. It sold the control of most of these firms to multinationals. As a Mediterranean country with a foot in both the Middle East and Africa, Egypt offered a unique location as well as low energy and labour costs and a growing domestic market.

The effect of privatization was almost immediate, Ghoneim says. "Before 1999, Suez Cement and Torah Cement were the market leaders. However, since 1999 they have lost market leadership to other producers, especially the two leading private sector companies.... who were able to take market share away from government-controlled firms through better management, innovative distribution, and aggressive marketing techniques."

With the adoption of a free market policy and privatization, the Office of Selling Egyptian Cement was restructured and renamed the Cement Industry Committee (CIC). One of CIC's main responsibilities was to control the price of cement in the domestic market. The government also intervened directly to protect Egyptian producers, using measures such as import controls and duties. "Some viewed the import duties as providing unnecessary protection," Ghoneim reports. "Others believed that such duties protected the local industry from dumping of imported cement."

The increases in efficiency and productivity following privatization were so marked that there was soon an excess supply of cement and a drop in prices but not for long. The price of cement in Egypt has risen in recent years, climbing from about US\$24 a tonne in 2003 to around US\$73 by 2007 despite CIC's efforts to control prices. Producers claim the rising prices were driven by a



Egyptian Cement Company

**While privatization is an important step toward a free and fair market, it does not by itself ensure competition.**

combination of factors, including record economic growth in Egypt and a boom in real estate.

"Cement is a very good barometer of the overall economic situation," says Omar Mohanna, chairman of the country's largest cement manufacturer, Suez Cement.

## Demand for exports

Other players in the market, such as Ali Moussa, president of United Paints and Chemicals, suggest that the demand for exports was the main factor contributing to soaring prices. Moussa points to the demand for materials for reconstruction resulting from war and natural disasters. "There are five or six countries that will have a huge demand for reconstruction. Moreover, demand will increase as well in our region because of increasing oil prices, which have encouraged governments to set programs for construction and development," Moussa says.

Ghoneim agrees. "The construction boom in the Gulf and the reconstruction of Iraq, accompanied by higher profit margins from exporting rather than selling domestically are the main reasons behind the skyrocketing prices." He adds that even with these higher prices, Egyptian exports of cement are very competitive in the region.

The industry also benefits from very low energy costs because of Egypt's reserves of natural gas. Cement companies buy gas at the same price as it is sold to multinational gas companies. The proximity of cement factories to the gas fields means that the producers also save on transportation costs. "As long as Egypt's gas reserves last and



**Competition policy and law are tools that need to be in place before privatization occurs in order to ensure that the result is healthy competition.**

processing and transport costs remain relatively low, Egypt's cement industry will continue to benefit from a sustainable competitive advantage of low energy costs," Ghoneim says.

By 2003 Egypt ranked fifth among the world's cement-exporting nations. The industry's competitive edge was given a boost that year by the government's decision to float the Egyptian currency, which had until then been pegged at an unrealistically high level. The subsequent drop in the value of the currency increased the demand for Egyptian cement in established export markets in neighbouring countries such as Algeria, Libya, Sudan, and Tunisia. In addition, Ghoneim notes that "the Egyptian cement industry is well positioned to become an exporter into the Mediterranean Basin and the Red Sea." He believes that most cement companies have not yet realized their full export potential, and that many are still in the early stages of penetrating foreign markets.

## High domestic prices

It was clear by this time that, while privatization is an important step toward a free and fair cement market, it would not by itself ensure competition between firms. As Ghoneim concluded in his 2004 study, "The industry has experienced all features of anticompetitive behaviours, ranging from collusive arrangements to price wars to formidably high prices."

"The government has always tried to [...] regulate the market, and each time it failed, or its success was limited," Ghoneim notes. "The two most important solutions for this

dilemma were absent competition and consumer protection laws and the ability of the government to impose export taxes." Export taxes were a "second best solution" to reorient the interests of producers back to satisfying the needs of the domestic market, Ghoneim says. In his view, the better approach was to enact enforceable competition and consumer protection laws. Enactment of a competition law, in particular, would have provided means to address allegations of price fixing, from many in the construction industry.

These allegations appeared to be confirmed, at least in the case of steel: a 2004 report published by the government's Central Auditing Organization indicated that the rate of increase in steel prices far exceeded increases in production cost. The report sparked a furious debate in the People's Assembly, which led to calls for export quotas and reductions in customs and anti-dumping tariffs.

Ghoneim describes what happened next. "The Minister of Trade and Industry imposed [a tax] on cement exports. Domestic prices were supposed to decrease. In fact, the minister tried this several times, but it seems it was not effective to stop the increase in prices."

Then, in 2007, the government brought in a new policy that was intended to claw back some of the cement and steel producers' extraordinary profits and increase public finance revenue. It introduced a measure to reduce energy subsidies to domestic heavy industry, including cement producers. By prime ministerial decree the price of gas will be raised to the international price equivalent over the next three years.

## Legislation at last

The People's Assembly also demanded, and got, immediate progress on finalizing a bill to bring in antimonopoly rules and competition law. This legislation had been in the works since 1995 with little sign of progress. At least 17 drafts were circulated before it was finally issued in 2005. At that point it was fast-tracked through parliament, with members passing it into law after just six sessions of debate.

Not surprisingly, the cement industry is involved in the antimonopoly law's first major test. At the request of Rachid Mohamed Rachid, Minister of Trade and Industry, the Egyptian Competition Authority (ECA), created in 2006, began investigating the pricing of both cement and steel.

The ECA found that the cement producers had indeed colluded to control cement prices through an agreement that limited the market share of each producing company. The prosecutor-general investigated the activities of the cement companies that were party to that agreement and referred the case to a criminal court in January 2008. Meanwhile, the ECA's investigation of the steel industry continues.

Ghoneim welcomes the new legislation. He believes that the sequence of market reforms was faulty. A competition law needs to be in place before privatization occurs in order to ensure that healthy competition results. "This was a case where the cart was put before the horse," he says. "Institutions should precede policies or at least go in tandem if we are looking for an effective market economy outcome."

*This case study was written by Bob Stanley, a writer in Ottawa. It is based on a draft paper, The Egyptian Cement Industry Case, by Ahmed Farouk Ghoniem.*

*The views expressed in this case study are those of IDRC-funded researchers and of experts in the field.*

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